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HONORS THESIS

The Affordable Care Act raises the stakes on worker classification; what does this mean for the Voluntary Classification Settlement Program

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ABSTRACT

This research considers worker classification and the many implications an employer must consider when classifying a worker as employee or independent contractor. One implication relates to healthcare benefits and healthcare taxes. As such, this research will evaluate the new healthcare taxes and implications resulting from the Affordable Care Act. Furthermore, this research will relate and explain worker classification with regards to the Voluntary Classification Settlement Program. This is a program offered by the Internal Revenue Service allowing employers to prospectively classify workers as employees with tax relief for past misclassification. The healthcare implications from the Affordable Care Act have raised the stakes on worker classification. This research will confirm whether this will provide greater incentive for employers to classify workers as employees or independent contractors.

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INTRODUCTION

Taxes play a vital role in our society as they are used for the many public services and resources we utilize. The taxes we pay are used for transportation, education, healthcare, law and order, housing, media, trade and industry, the environment, and overseas development and defense. Consequently, it is evident that tax dollars from a variety of sources are used to provide value to the general population through the development of communal services and resources. When tax payers fail to file a tax return, understate their income, overstate deductions, or fail to fully pay their reported taxes owed, they are contributing to the Tax Gap.¹ The tax gap is the difference between taxes voluntarily reported and paid by taxpayers compared with taxes the IRS has determined are actually due.² Recent IRS data for 2006 reveal \$385 billion in unpaid federal taxes, \$95 billion higher than the \$290 billion previously estimated for 2001. This shortfall, known as the tax gap, is attributable to 14.5% of taxpayers failing to comply with the tax laws.³ Moreover, close to \$1.6 billion out of the \$385 billion is directly related to the issue of worker misclassification.⁴

In an effort to reduce this tax gap and rectify worker misclassification, the IRS introduced the Voluntary Classification Settlement Program (VCSP) in 2011. This program provides relief to employers who have misclassified their workers as independent contractors when they should have been treated as employees. Often, the reason for misclassification is attributed to cost savings for the employer. When classifying a worker as either employee or independent contractor, the employer must consider tax costs, worker benefits, and other potential costs related to an employee or independent contractor. An employer must pay state

¹ See IRS News Release FS-2012-6, Tax Year 2006 Tax Gap Estimate – Summary of Estimation Methods (January 2012)

² *Id.*

³ See IRS News Release IR-2012-4, IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study, (Jan. 6, 2012)

⁴ Morgan-Thomas, Maxine, and Helisse Levine. "Tax-Gap Closers of Recent US Budget Proposals and Tax Legislation." THE CPA JOURNAL (2012): 34-40.

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and federal unemployment taxes, a portion of the FICA tax, and certain benefits for employees. On the other hand, these costs can be avoided by classifying the worker as an independent contractor. Worker classification has been an ongoing battle between the IRS and taxpayers. In its first full year of engagement, the VCSP was well received. As of February 2013, nearly 1000 employers had applied for the VCSP.⁵ Consequently, the IRS expanded the program by offering to waive certain eligibility requirements until June 30, 2013.⁶ With this expansion, the IRS hoped to attract more employers, especially larger ones, to participate in the VCSP.

Worker classification involves many implications, such as the taxes associated with each classification and the benefits one receives as an employee. One of these benefits an employee could be entitled to relates to medical benefits. This is an interesting component to analyze with regards to worker classification, as the Affordable Care Act is currently being transitioned into place. We are currently experiencing a shift in our national healthcare system which is inevitably affecting everyone. Employers will soon be required to offer health care policies to at least 95% of their full-time employees.⁷ This transition raises the stakes on worker classification. As such, this research will further explore the Voluntary Classification Settlement Program and what impact the Affordable Care Act will have on this program.

⁵ See IRS News Release IR-2013-23, IRS Expands Voluntary Worker Classification Settlement Program; Relief From Past Payroll Taxes Available to More Employers Who Reclassify Their Workers As Employees, (February 27, 2013)

⁶ Under the revamped program, employers under IRS audit, other than an employment tax audit, can qualify for the VCSP. Furthermore, employers accepted into the program will no longer be subject to a special six-year statute of limitations, rather than the usual three years that normally applies to payroll taxes. The temporary initiative permits taxpayers who are otherwise eligible for the VCSP, but have not filed all required Forms 1099 for the previous three years with respect to the workers to be reclassified, to apply for a modified version of the VCSP, the VCSP Temporary Eligibility Expansion.

⁷ See Federal Register Vol. 79, No. 29. IRS Code Section 4980H - Shared Responsibility for Employers Regarding Health Coverage. (February 12, 2014)

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LITERATURE REVIEW

Internal Revenue Code Section 530

More than 30 years ago, Congress enacted a safe harbor for employers that had treated workers as independent contractors rather than employees, and had good reason for doing so. The safe harbor, while providing a measure of protection against reclassification, has not eliminated attempts by IRS to reclassify workers as employees. This provision, also known as Internal Revenue Code Section 530, has provided qualifying taxpayers with relief from federal employment tax liability. In “The Road to Section 530 Relief can have many Twists and Turns,” Bird, Hopper, and Platau explain I.R. Code section 530 requirements, some additional considerations, and various major cases that have involved the safe harbor provision.⁸ To qualify for I.R. Code section 530 relief, the business must satisfy both the reporting consistency and substantive consistency tests, along with one of four reasonable basis tests. Additionally, Section 530(e)(6) requires that the taxpayer must not have treated any worker in question as an employee at any time after 1977.⁹ Although I.R. Code section 530 terminates a business’s employment tax liability and any interest or penalties that follow, it does not terminate a worker’s employment tax liability. I.R. Code Section 530 represents one of congress’s initial efforts to rectify worker misclassification. Since then, two more programs (the Voluntary Classification Settlement Program and the National Research Program) have been introduced, both aimed at rectifying worker misclassification and reducing the tax gap.

The National Research Program

The National Research Program (NRP) was created to design and implement a successful strategy to collect data that will be used to measure payment, filing and reporting compliance. However, the IRS also uses the NRP to analyze taxpayer compliance and to

⁸ See Internal Revenue Manual (IRM) 4.23.5, Employment Tax, Technical Guidelines for Employment Tax Issues. (December 10, 2013)

⁹ *Id.*

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assess the effectiveness of compliance programs and treatments in use by the IRS. Data for analysis will include amounts reported by taxpayers on their tax returns and the corrected amounts that were determined by examiners.¹⁰ Therefore, a component of the NRP consists of the IRS conducting employment tax audits for thousands of randomly selected businesses. NRP employment tax audits focus on identifying and resolving worker misclassification issues. Following the analysis of the NRP, Amy Lehmkuhl,¹¹ author of *Options for Compliance With Worker Classification Rules*, discusses the VSCP and its effect on the tax gap. Prior to the VCSP, only taxpayers under audit could rectify their worker classification issues and obtain relief from federal taxes. Taxpayers could achieve this through the Classification Settlement Program (CSP).¹² Consequently, the VCSP was established to allow taxpayers to properly classify workers prospectively while also gaining tax liability relief for previous misclassification.

The Voluntary Classification Settlement Program

In addition to Amy Lehmkuhl's analysis, the VCSP is also explained by Juliet L. Fink and Megan L. Brackney in *Worker Misclassification: The real cost of the IRS's new settlement program*. This article is one of the more comprehensive regarding coverage of the VCSP. The authors begin by explaining the benefits of the VCSP and its effect on the tax gap: "The VCSP is part of a larger "fresh start" initiative by the IRS to encourage taxpayers and businesses to get compliant while giving them financial certainty under the VCSP's penalty framework. The announcement of the VCSP was made in the wake of recent efforts by the IRS and the U.S. Department of Labor (DOL) to increase enforcement of worker

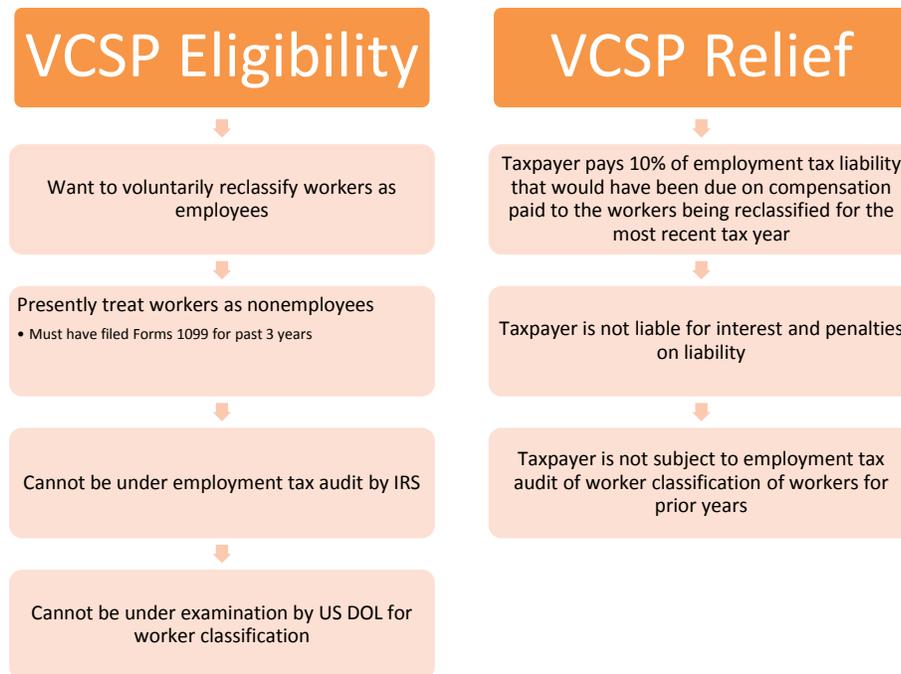
¹⁰ National Research Program (NRP) <http://www.irs.gov/uac/National-Research-Program-%28NRP%29>

¹¹ Lehmkuhl, Amy. "Options for Compliance With Worker Classification Rules." *The Tax Adviser* 44.7 (2013): 478-80.

¹² The Classification Settlement Program, "CSP", allows taxpayers and tax examiners to resolve worker classification cases as early in the administrative process as possible, reducing taxpayer burden. The procedures also ensure that the taxpayer relief provisions under Section 530 of the Revenue Act of 1978 are properly applied. Under the CSP, Internal Revenue Service (IRS) examiners are able to offer taxpayers under examination a worker classification settlement using a standard closing agreement. IRM 04-023-006 Employment Tax, Classification Settlement Program (CSP). (March 20, 2012)

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classification and related employment tax obligation.”¹³ They then define what an employee is and what factors to consider when differentiating between employee and independent contractor. In defining an employee they also note the various taxes an employer is required to withhold from amounts paid to an employee. Next, they move on to the eligibility and terms of the VCSP. The chart below specifies the requirements for participating in the program and also the relief employers receive for participating in the program.



Businesses can apply for the VCSP by filing IRS form 8952, “Application for Voluntary Classification Settlement Program.” (Refer to Appendix A) This application should be filed at least 60 days prior to the date the taxpayer wants to reclassify their workers

¹³ Fink, Juliet L., and Megan L. Brackney. "Worker Misclassification: The Real Cost of The IRS's New Settlement Program." Practical Tax Strategies 89.4 (2012): 148-55. Print.

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to employee status.¹⁴ Although on face-value the program seems beneficial for all of the parties involved, there are still flaws associated with the VCSP. For example, the authors note that the program "leaves the workers, who in most cases had no control over their original classification, vulnerable to additional employment tax liability as well as penalties and interest."¹⁵ It is important to note that even after the business goes through the VCSP, employees could still be liable for unpaid taxes. Furthermore, misclassified employees are often denied access to critical benefits and protections – such as family and medical leave, overtime, minimum wage and unemployment insurance – to which they are entitled. Employee misclassification also generates substantial losses to the Treasury and the Social Security and Medicare funds, as well as to state unemployment insurance and workers compensation funds. If a worker thinks they are being misclassified, they could file a request to the IRS to perform an audit of the business for classification purposes.

State Implications of Worker Reclassification

Along with overlooking the consequences for employees, the VCSP does not account for state implications and liabilities resulting from worker reclassification. Although many states currently follow federal legislation when addressing worker misclassification, this is an area that states are looking to develop their own set of rules and consequences for. Consequently, many states are currently in the process of establishing a defined set of consequences for both the employers and workers that are involved in worker misclassification. When determining whether a worker is employee or independent contractor, most states use some version of the “ABC test.” Similar to the common law test used by the IRS, the ABC test focuses on control, and “looks to whether: 1) the worker is free from control and direction in the performance of services, 2) the services performed are outside of the usual course of the business’s premises, and 3) the worker is customarily

¹⁴ Voluntary Classification Settlement Program <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Voluntary-Classification-Settlement-Program>

¹⁵ Fink, Juliet L., and Megan L. Brackney. "Worker Misclassification: The Real Cost of The IRS's New Settlement Program." *Practical Tax Strategies* 89.4 (2012): 148-55. Print.

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engaged in an independently established trade, occupation, or profession of the same nature as that involved in the services performed.”¹⁶ In summary, it could be tough for employers to assess the cost of participating in the VCSP as State implications for worker reclassification could be different from federal implications.

Employee vs. Independent Contractor

At the root of the VCSP, and other programs aimed at resolving worker misclassification, is the understanding of what differentiates an employee from and independent contractor. In “Classifying Independent Contractors and Employees,” Mary Recor thoroughly explains the differences¹⁷. She states, “the general rule is that an individual is an independent contractor if the person for whom the services are performed has the right to control or direct only the result of the work, not the means or method of accomplishing that result. Comparatively, any individual who performs services is an employee if the employer has the right to control both the work that will be done and how it will be done (i.e. behavioral control).”¹⁸

Years of analyzing numerous court cases that involved worker misclassification resulted in the IRS developing a list of twenty factors they deem are relevant in determining whether an employer-employee relationship exists.

¹⁶ *Id.*

¹⁷ Recor, Mary. "Classifying Independent Contractors and Employees." THE CPA JOURNAL (2012): 48-53.

¹⁸ See Independent Contractor (Self-Employed) or Employee? <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Independent-Contractor-Self-Employed-or-Employee>

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| The IRS's 20 Factors for Classification | |
|---|---|
| <i>Instructions</i> | If the employer has the right to require compliance with instructions, this indicates employee status. |
| <i>Training</i> | Worker training (e.g., by requiring attendance at training sessions) indicates that the person for whom services are performed wants the services performed in a particular manner (which indicates employee status). |
| <i>Integration</i> | Integration of the worker's services into the business operations of the person for whom services are performed is an indication of employee status. |
| <i>Services rendered personally</i> | If the services are required to be performed personally, this is an indication of that the person for whom services are performed is interested in methods used to accomplish the work (which indicates employee status). |
| <i>Hiring, supervision, and paying assistants</i> | If the person for whom services are performed hires, supervises or pays assistants, this generally indicates employee status. However, if the worker hires and supervises others under a contract pursuant to which the worker agrees to provide material and labor and is only responsible for the result, this indicates independent contractor status. |
| <i>Continuing relationship</i> | A continuing relationship between the worker and the person for whom the services are performed indicates employee status. |
| <i>Set hours of work</i> | The establishment of set hours for the worker indicates employee status |
| <i>Full time required</i> | If the worker must devote substantially full time to the business of the person for whom services are performed, this indicates employee status. An independent contractor is free to work when and for whom he or she chooses. |
| <i>Doing work on employer's premises</i> | If the work is performed on the premises of the person for whom the services are performed, this indicates employee status, especially if the work could be done elsewhere. |
| <i>Order or sequence test</i> | If a worker must perform services in the order or sequence set by the person for whom services are performed, that shows the worker is not free to follow his or her own pattern of work, and indicates employee status. |
| <i>Oral or written reports</i> | A requirement that the worker submit regular reports indicates employee status |

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| | |
|--|---|
| <i>Payment by the hour, week or month</i> | Payment by the hour, week, or month generally points to employment status; payment by the job or a commission indicates independent contractor status |
| <i>Payment of business and/or travelling expenses</i> | If the person for whom the services are performed pays expenses, this indicates employee status. An employer, to control expenses, generally retains the right to direct the worker. |
| <i>Furnishing tools and materials</i> | The provision of significant tools and materials to the worker indicates employee status. |
| <i>Significant investment</i> | Investment in facilities used by the worker indicates independent contractor status. |
| <i>Realization of profit or loss</i> | A worker who can realize a profit or suffer a loss as a result of the services (in addition to profit or loss ordinarily realized by employees) is generally an independent contractor. |
| <i>Working for more than one firm at a time</i> | If a worker performs more than de minimis services for multiple firms at the same time, that generally indicates independent contractor status. |
| <i>Making service available to the general public</i> | If a worker makes his or her services available to the public on a regular and consistent basis, that indicates independent contractor status. |
| <i>Right to discharge</i> | The right to discharge a worker is a factor indicating that the worker is an employee. |
| <i>Right to terminate</i> | If a worker has the right to terminate the relationship with the person for whom services are performed at any time he or she wishes without incurring liability, that indicates employee status. |
| Source: Present Law and Background Relating to Worker Classification for Federal Tax Purposes http://www.irs.gov/pub/irs-utl/x-26-07.pdf | |

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The IRS's 20 Factors for Classification is a comprehensive list that helps employers and the IRS determine whether a worker is employee or independent contractor. However, the sheer number of factors allows for a sense of subjectivity and cloudiness to be infused in the determination. Consequently, an employer might argue the worker is an independent contractor after assessing a few of the factors they think are important, while the IRS insists the worker is an employee due to their emphasis on some of the other factors they value as more important. As a result of this "grey area," the IRS has identified three categories of evidence that may be relevant in determining whether the requisite control exists under the common-law test and has grouped illustrative factors under these three categories: 1) behavioral control; 2) financial control; and 3) relationship of the parties.¹⁹ Due to the nature and complexity of classification as employee or independent contractor, the person assigning the status must step back and look at the big picture: The keys are to look at the entire relationship, consider the degree or extent of the right to direct and control, and finally, to document each of the factors used in coming up with the determination.²⁰

Atig Rahman v. Comm'r (T.C. Memo 2014-35)

A recent case that exemplifies this issue is *Atig Rahman v. Comm'r* (T.C. Memo 2014-35). In this case, the court attempted to determine whether Atig Rahman was an employee or independent contractor of Ever Care Adult Services (Ever Care). Ever Care was a business that provided home and other care services to adults with disabilities. During 2010 Ever Care owned three homes and acquired a fourth. Ever Care hired both floor staff and group home managers.

Ever Care originally hired Rahman to be a member of floor staff, but he was promoted to group home manager after working approximately two weeks. Rahman worked

¹⁹ See Independent Contractor (Self-Employed) or Employee? <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee>

²⁰ *Id.*

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approximately 40 hours per week and was paid an hourly rate every two weeks. When he was not working, Rahman was on call as the first point of contact should a problem arise at the home. Rahman did not have any ownership interest in Ever Care or in any of the properties associated with Ever Care. There is nothing in the record to indicate that either party intended Rahman's employment to be temporary or short term.

When Ever Care hired Rahman, Ever Care specifically enumerated his duties and responsibilities, many of which were required by the State of Florida to maintain an adult care facility. A copy of such duties and responsibilities was posted in each of Ever Care's group homes. Ever Care specified not only Rahman's particular job duties, but also when and where to perform them.

Rahman's duties included: preparing a monthly forecast of finances; purchasing groceries for the home; meeting with officials from the Florida licensing agency; maintaining the home and making repairs; and scheduling, hiring, and firing staff. Rahman's duties also included assisting residents with personal grooming and facilitating transportation for them.

Rahman provided Ever Care's owner with financial projections each month and met with the owner weekly for an accounting of grocery purchases. He also reported to the owner daily regarding how the home was running. In addition, Rahman would contact the owner in the event of any emergency.

Ever Care paid for the weekly groceries for the residents as well as for upkeep and repairs to the home. Rahman did not incur any out-of-pocket expenses related to his work at Ever Care.

In or around early 2011 Ever Care discharged Rahman. Ever Care considered Rahman to be an independent contractor and provided him with a Form 1099-MISC, Miscellaneous Income, for 2010.

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The respondent mailed Rahman a notice of deficiency for 2010, determining a deficiency of \$7,038 and an accuracy-related penalty of \$1,115. In the notice, respondent determined that Rahman was an independent contractor of Ever Care and therefore liable for self-employment tax.

Rahman timely filed a petition for redetermination, alleging that he was an employee of Ever Care and therefore not liable for self-employment tax.

At trial Rahman credibly testified that “[the owner had] a certain way of doing things and we had to follow that to the ‘T’,” and “[the owner] always had, it was always a certain, specific protocol that she always wanted us to do”. Indeed, in that regard Ever Care specifically enumerated Rahman’s duties and responsibilities and posted a copy thereof in each of Ever Care’s homes. Ever Care also instructed Rahman regarding when and where to perform his duties.

Rahman was obligated to contact the Ever Care’s owner daily to report the status of the home he managed. He was further obligated to contact Ever Care’s owner to request that repairs be made and in the event of an emergency. In addition, Rahman met with the owner weekly to account for groceries, and he prepared a financial projection each month, which he provided to Ever Care’s owner.

On the basis of these facts, we find that Ever Care had the right to control Rahman’s work and that it did, in fact, exercise a high degree of control over it. This factor weighs heavily in favor of a finding that Rahman was a common law employee of Ever Care.

The fact that a worker provides his or her own tools or goods generally indicates independent contractor status. Rahman did not supply any tools or goods to the group home he managed. Ever Care provided Rahman money each week for him to buy groceries. In addition, Ever Care paid for any repairs made to the home. Rahman had no out-of-pocket costs relating to his work at Ever Care. This factor indicates that Rahman was a common law employee.

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Rahman had no other opportunity for profit or risk of loss in Ever Care. This factor indicates that petitioner was a common law employee.

Ever Care retained the right to discharge Rahman and in fact discharged him in or around early 2011. This factor indicates that petitioner was a common law employee.

Where a type of work is part of the principal's regular business, it is indicative of employee status. In the instant case, Ever Care's business was to provide homes and services to adults with disabilities. Rahman's work with Ever Care was managing one of Ever Care's four homes, including hiring staff, grocery shopping for the residents, maintaining the home, and meeting with officials from the Florida licensing agency to ensure that the home was running properly. When Rahman was not working, he was on call as the first point of contact should a problem arise. Thus, the work Rahman performed was an integral part of Ever Care's regular business. This factor indicates that Rahman was a common law employee.²¹

In conclusion, the court ruled that Atig Rahman was in fact an employee of Ever Care. Accordingly, he was not liable for self-employment tax pursuant to section 1401 on income earned from Ever Care in 2010.

²¹ See *Atig Rahman v. Comm'r* (T.C. Memo 2014-35) United States Tax Court (April 15, 2014)

METHODOLOGY OF REVIEW

My research of the thesis is built around three main topics or ideas. Developing a thorough understanding of the worker misclassification issue, the Voluntary Classification Settlement Program, and the Affordable Care Act is essential to arriving at an answer to the thesis. The research methodology I employed throughout this project consisted mainly of compiling a base of resources that contained general information on the topics, and then digging deeper for the details after doing an initial analysis of the material. In essence, I strived to pick out all of the factual information associated worker classification and the VCSP, like definitions, the purpose of the program, and implications of the participating in the program, and then once this base was established, I shifted my efforts towards synthesizing some of the more subjective data that has been published on these topics.

The main resources used for research include, but are not limited to, the Tax Advisor, Journal of Taxation, Practical Tax Strategies, CPA Journal, Presidential Budget for 2014, and online resources for facts on the Affordable Care Act. The research review began with a few articles on the VCSP. After reading these articles I found that the main issue the VCSP was looking to resolve concerned worker misclassification. From this I understood it was imperative to conduct a thorough evaluation of the worker misclassification issue as it would be the base from which all of my other research would build off. As such, I started by evaluating the criteria used to distinguish employees from independent contractors. After defining the terms, I considered the different monetary and tax implications involved with each classification. This was extremely important to the reviewing phase because it helped me better understand why an employer might want to classify their worker as independent contractor or why a worker might want to rather be classified as employee.

Moving forward, I shifted the focus of my research review towards staying up to date with the trends in worker reclassification and the VCSP. One aspect of this was outlining the evolution of the VCSP. Since its implementation in September 2011, the program has also released a temporary expansion which encouraged larger employers to participate in the

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program. With this expansion, the IRS loosened some of their eligibility requirements, yet they also increased the cost of participating in the program during the phase of the temporary expansion (refer to Appendix B for new payment calculation under Temporary Eligibility Expansion of VCSP).²² This was interesting to see as it was developed in response to the positive reception of the VCSP. As of 2013, nearly 1,000 employers had already applied for the VCSP.²³

Once a comprehensive understanding of the VCSP and worker misclassification was established, I moved my focus towards the Affordable Care Act. At the time I began analyzing it, the act was still being voted on in congress so I tried to gain a better understanding of the fundamental points behind it rather than some of the more detailed components. In this analysis, I first did a general read-through to establish what the act aims to achieve and how they plan on doing so. However subsequent to this, I started focusing more on the tax implications imbedded in the affordable care act. In addition to that, I looked form trends in the news concerning how employers were reacting to the ACA. This analysis was more directed towards understanding how employers and workers were responding to the new health care Marketplace, and whether or not this would affect the composition of human resources in the workplace. With regards to the structuring of human resources, I was interested in seeing whether businesses might be more inclined to increase the number of part time employees in the workplace as a result of changing health care policies.

In summary, my methodology for reviewing the material consisted primarily of examining documents and articles, and referencing laws and amendments to their sourced IRS announcements or legislative announcements. This approach was taken to ensure accuracy

²² See IRS News Release IR-2012-51, Voluntary Classification Settlement Program – Temporary Eligibility Expansion, Announcement 2012-46 (December 17, 2012)

²³ See IRS News Release, IR 2013-23, IRS Expands Voluntary Worker Classification Settlement Program; Relief From Past Payroll Taxes Available to More Employers Who Reclassify Their Workers As Employees (February 27, 2013)

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and consistency in the information I obtained. Although the primary focus of this project is on the tax consequences of the Voluntary Classification Settlement Program and certain aspects of the Affordable Care Act, I strived to constantly evaluate the data and information in terms of its effects on the employer, employee, and independent contractor. This was accomplished by trying to relate both numerical and qualitative implications to all parties involved in the VCSP.

FINDINGS AND EVALUATION OF THE RESEARCH

The tax gap in the United States of America, as of 2006, is \$385,000,000,000. This is a huge problem as this money should be going towards the development of public services and other government projects. As employment taxes are a significant source of revenue for the federal government, improper worker classification contributes to the tax gap. This improper classification refers to employers classifying workers as independent contractors when they should be classified as employees.

Classifying a worker as an employee means the employer is responsible for paying the employer's portion of Federal Insurance Contributions Act (FICA) taxes, which consist of Social security and Medicare, federal unemployment taxes, state unemployment taxes, and disability insurance, as well as providing many employee benefits. These benefits include vacation pay and medical benefits, amongst others. Contrastingly, if the employer has classified the worker as independent contractor, they do not incur these tax costs for that particular worker. The independent contractor is responsible for paying the Self-employment tax.

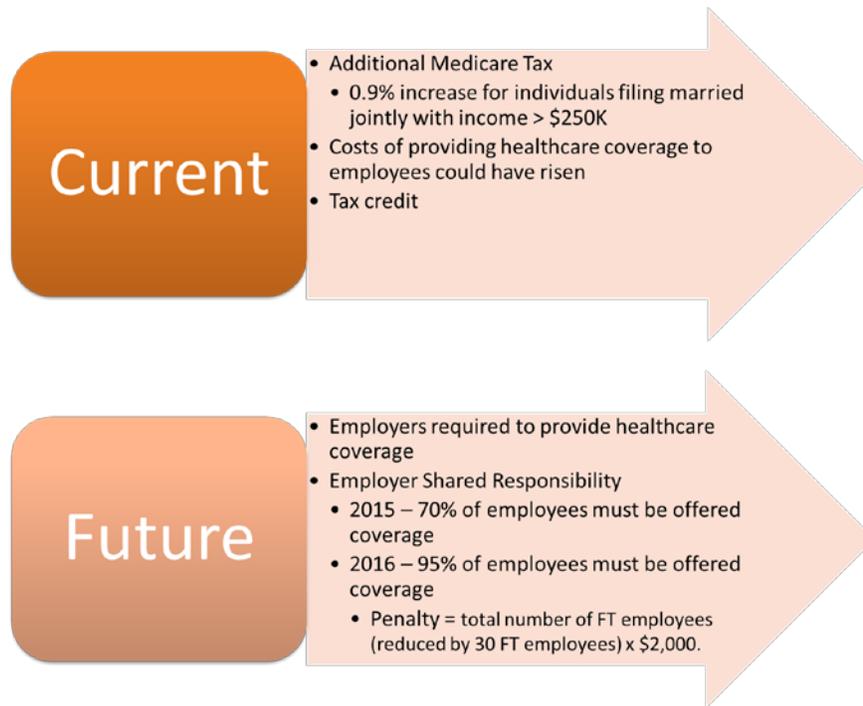
In an effort to reduce the tax gap while also rectifying worker misclassification, the IRS introduced the Voluntary Classification Settlement Program in 2011. The requirements to participate, the relief obtained for worker reclassification, and other related implications have been discussed in the literature review, but one thing to note is the positive reception of this program. This positive reception encouraged the IRS to offer a temporary eligibility

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expansion allowing for more businesses to participate. Interestingly enough, during this time, the U.S. healthcare system was undergoing a major transformation. This transformation has a profound impact on worker classification as the health care benefits and the health insurance plans employers offer their employees are changing. In some cases, the cost of these plans has increased, causing employers to reconsider the manner in which they offer compensation for health care benefits. For example, some employers, like IBM and Walgreen Co.,²⁴ have found that it is cheaper for employees to get their own health care plans through the Marketplace. Consequently, a few of these employers have decided to give the employees a slight pay raise in lieu of providing health care coverage. It is evident the Affordable Care Act has had a profound effect on many businesses. The implications of the Affordable Care Act are different for each employer as they would have to assess the health care plans they are currently providing to employees and subsequently see if it is cheaper for the employee to buy health care policies through the Marketplace. However, there are still a few tax implications of the Affordable Care Act that are much less indirect.

²⁴ "First Glimpses of a New Health Care World - Fortune Management." Fortune Management Career Blog RSS. N.p., n.d. Web. 22 Apr. 2014. <<http://management.fortune.cnn.com/2013/09/20/health-care-ibm-walgreen/>>.

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Currently, there is a 0.9% increase in the Medicare Tax for taxpayers with certain income thresholds.²⁵

| Filing Status | Threshold Amount |
|--|------------------|
| Married filing jointly | \$250,000 |
| Married filing separate | \$125,000 |
| Single | \$200,000 |
| Head of household (with qualifying person) | \$200,000 |
| Qualifying widow(er) with dependent child | \$200,000 |

There are also certain tax credits available for small businesses that provide health insurance coverage to their employees. For example, the Small Business Health Care Tax Credit helps small businesses and small tax-exempt organizations afford the cost of covering their employees and is specifically targeted for those with low- and moderate-income workers. The credit is designed to encourage small employers to offer health insurance

²⁵ See IRS TD 9645 – Rules Relating to Additional Medicare Tax. <https://s3.amazonaws.com/public-inspection.federalregister.gov/2013-28411.pdf>

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coverage for the first time or maintain coverage they already have. In general, the credit is available to small employers that pay at least half the cost of single coverage for their employees.²⁶

Another major tax implication resulting from the Affordable Care Act is the Employer Shared Responsibility tax. For 2015 and after, employers employing at least a certain number of employees (generally 50 full-time employees or a combination of full-time and part-time employees that is equivalent to 50 full-time employees) will be subject to the Employer Shared Responsibility provisions under section 4980H of the Internal Revenue Code (added to the Code by the Affordable Care Act). As defined by the statute, a full-time employee is an individual employed on average at least 30 hours of service per week. An employer that meets the 50 full-time employee threshold is referred to as an applicable large employer. Under the Employer Shared Responsibility provisions, if these employers do not offer affordable health coverage that provides a minimum level of coverage to their full-time employees (and their dependents), the employer may be subject to an Employer Shared Responsibility payment if at least one of its full-time employees receives a premium tax credit for purchasing individual coverage on one of the new Affordable Insurance Exchanges, also called a Health Insurance Marketplace (Marketplace).²⁷

For 2015 and after, an applicable large employer will be liable for an Employer Shared Responsibility payment only if:

(a) The employer does not offer health coverage or offers coverage to fewer than 95% of its full-time employees and the dependents of those employees, and at least one of the full-time employees receives a premium tax credit to help pay for coverage on a Marketplace;

OR

²⁶ See IRS Affordable Care Act Tax Provisions. <http://www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions>

²⁷ See IRS Questions and Answers on Employer Shared Responsibility Provisions Under the Affordable Care Act. <http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act>

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(b) The employer offers health coverage to all or at least 95% of its full-time employees, but at least one full-time employee receives a premium tax credit to help pay for coverage on a Marketplace, which may occur because the employer did not offer coverage to that employee or because the coverage the employer offered that employee was either unaffordable to the employee or did not provide minimum value.²⁸

If an applicable large employer does not offer coverage or offers coverage to fewer than 95% of its full-time employees (and their dependents), it owes an Employer Shared Responsibility payment equal to the number of full-time employees the employer employed for the year (minus up to 30) multiplied by \$2,000, as long as at least one full-time employee receives the premium tax credit. For an employer that offers coverage for some months but not others during the calendar year, the payment is computed separately for each month for which coverage was not offered. The amount of the payment for the month equals the number of full-time employees the employer employed for the month (minus up to 30) multiplied by 1/12 of \$2,000. If the employer is related to other employers (see question 6 above), then the 30-employee exclusion is allocated among all the related employers in proportion to each employer's number of full-time employees.²⁹

This excise tax could be an issue for many businesses as they have to make sure they are offering health care coverage to at least 95% of their employees. With only a year left to ensure compliance with this percentage, some businesses could require restructuring. Whether this means restructuring the number of employees they have and their hours or just changing up how they offer compensation for certain benefits, the stakes on worker classification have been raised.

The implications and increased costs resulting from the Affordable Care Act negatively impact participation in the Voluntary Classification Settlement Program. The implementation of the Affordable Care Act has not been smooth and transparent. Consequently, there is a lot of confusion and uncertainty around the costs associated with

²⁸ *Id.*

²⁹ *Id.*

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health care coverage. There were also problems with the Health Care Exchanges, or Marketplaces, as many people had trouble signing up and participating in this new program. This uncertainty has made it difficult for employers to calculate the true costs associated with offering their employees' health care coverage under the guidelines of the Affordable Care Act. In turn, this also makes it tougher for employers to calculate their true cost of participating in the VCSP. Upon reclassifying their workers to employee status, the employers will have to offer health care coverage amongst other benefits, which is where the cloudiness forms. If they cannot calculate the true costs associated with reclassifying their workers, it might not be beneficial for them to reclassify at this point in time. Rather it might make more sense for them to wait until there is more clarity concerning the implications of the Affordable Care Act, and then proceed to participate in the VCSP. In summary, the Affordable Care Act has raised the stakes on worker classification, and therefore negatively affected participation in the Voluntary Classification Settlement Program.

CONCLUSION

Worker classification is a complex process that must account for both qualitative and quantitative factors. As a part of the quantitative factors, monetary and tax implications are a major consideration for employers. The introduction of the Affordable Care Act has made the quantitative consideration for worker classification more important. In fact, major companies like IBM and Walgreens Co. are restructuring their health care policies and human resources in response to the "reshaped American health care system."³⁰ This activity and change in the U.S. health care system consequently has a negative impact on the Voluntary Classification Settlement Program. The program encourages employers to participate and rectify their worker misclassification. With uncertainty around the costs associated with reclassifying

³⁰ "First Glimpses of a New Health Care World - Fortune Management." Fortune Management Career Blog RSS. N.p., n.d. Web. 22 Apr. 2014. <<http://management.fortune.cnn.com/2013/09/20/health-care-ibm-walgreen/>>.

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their workers, due to the changing health care system and new monetary implications, the growth in participation in the VCSP will be limited. All in all, the Affordable Care Act has negatively impacted participation in the VCSP and has raised the stakes on worker classification.

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APPENDICES

Appendix A – Form 8952 – Application for Voluntary Classification Settlement Program

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Form **8952**

(Rev. November 2013)

Department of the Treasury
Internal Revenue Service

Application for Voluntary
Classification Settlement Program (VCSP)

▶ Do not send payment with Form 8952.

▶ Information about Form 8952 and its separate instructions is at www.irs.gov/form8952.

OMB No. 1545-2215

Caution. Taxpayer must make certain representations in order to be eligible to participate in the VCSP. These representations can be found in Part V on page 2.

Part I Taxpayer Information

| | | | |
|---|--|--|--|
| 1 Taxpayer's name | | 2 Employer identification number (EIN) | |
| 3 Number and street (or P.O. box number if mail is not delivered to a street address) | | Room/Suite | |
| 4 City, town or post office, state, and ZIP code | | | |
| 5 Telephone number | | 6 Website address (optional) | |
| 7 Fax number (optional) | | 8 Email address (optional) | |
| 9 Type of entity. Check the applicable box: <input type="checkbox"/> Sole proprietorship <input type="checkbox"/> Cooperative organization described in section 1381 of the Internal Revenue Code <input type="checkbox"/> Joint venture <input type="checkbox"/> Tax-exempt organization <input type="checkbox"/> Partnership <input type="checkbox"/> State or local government (for worker class or position not covered under a section 218 agreement) <input type="checkbox"/> C corporation <input type="checkbox"/> Other (specify here) _____ <input type="checkbox"/> S corporation | | | |
| 10 Are you a member of an affiliated group? <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," complete the common parent information on lines 11-14. If "No," skip to Part II. | | | |
| 11 Name of common parent of the affiliated group | | 12 EIN of common parent | |
| 13 Number and street (or P.O. box number if mail is not delivered to a street address) of common parent | | | |
| 14 City, town or post office, state, and ZIP code of common parent | | | |

Part II Contact Person

Attach a properly completed Form 2848, Power of Attorney and Declaration of Representative, if applicable. Also see *Special instructions for Form 2848* in the instructions.

- Name and title of contact person _____
- Contact person's number and street (or P.O. box number if mail is not delivered to a street address) _____
- Contact person's city, town or post office, state, and ZIP code _____
- Contact person's telephone number _____
- Contact person's fax number (optional) _____
- Contact person's email address (optional) _____

Part III General Information About Workers To Be Reclassified

| | |
|--|--|
| <p>15 Enter the total number of workers from all classes to be reclassified. A class of workers includes all workers who perform the same or similar services.</p> | <p>16 Enter a description of the class or classes of workers to be reclassified. If more space is needed, attach separate sheets (see instructions).</p> |
| <p>17 Enter the beginning date of the employment tax period (calendar year or quarter) for which you want to begin treating the class or classes of workers as employees. This date should be at least 60 days after the date you file Form 8952 (see instructions).</p> <p style="text-align: center;">/ /</p> | |

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 37772H

Form **8952** (Rev. 11-2013)

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| | |
|-----------------|--------------------------------------|
| Taxpayer's name | Employer identification number (EIN) |
|-----------------|--------------------------------------|

Part IV Payment Calculation Using Section 3509(a) Rates (see instructions)

| | | | |
|---|-----------|--|-----------|
| 18 Enter total compensation paid in the most recently completed calendar year to all workers to be reclassified (see instructions) | 18 | | |
| 19 Multiply line 18 by 3.24% (.0324) | | | 19 |
| 20 Enter any compensation included on line 18 that exceeded the social security wage base for any worker or workers for the most recently completed calendar year (see instructions) | 20 | | |
| 21 Subtract line 20 from line 18 | 21 | | |
| 22 Multiply line 21 by 7.44% (.0744) [7.04% (.0704) for compensation paid prior to 2013] | | | 22 |
| 23 Add lines 19 and 22 | | | 23 |
| 24 Multiply line 23 by 10% (.10). This is the VCSP payment you will pay when you submit your signed closing agreement (see instructions) | | | 24 |

Part V Taxpayer Representations

Caution. *Since the representations include the penalty of perjury statement, the representations under Part V must be signed by the taxpayer, not the taxpayer's representative.*

A Treatment of Workers

- 1** Taxpayer wants to voluntarily reclassify certain workers as employees for federal income tax withholding, Federal Insurance Contributions Act, and Federal Unemployment Tax Act taxes (collectively, federal employment taxes) for future tax periods.
- 2** Taxpayer is presently treating the workers as nonemployees.
- 3** Taxpayer has filed all required Forms 1099 for each of the workers to be reclassified for the 3 preceding calendar years ending before the date of this application.
- 4** Taxpayer has consistently treated the workers as nonemployees.
- 5** There is no current dispute between the taxpayer and the IRS as to whether the class or classes of workers are nonemployees or employees for federal employment tax purposes.

B Examination

- 1** Taxpayer or, if applicable, any member of the taxpayer's affiliated group, is not under employment tax examination by the IRS.
- 2** Taxpayer is not under examination by the Department of Labor or any state agency concerning the proper classification of the class or classes of workers.
- 3a** Taxpayer has not been examined previously by the IRS or the Department of Labor concerning the proper classification of the class or classes of workers; or,
- b** Taxpayer has been examined previously by the IRS or the Department of Labor concerning the proper classification of the class or classes of workers and the taxpayer has complied with the results of the prior examination.

Caution. Do not send payment with Form 8952. You will submit payment later with your signed closing agreement. If you submit payment with Form 8952, it may cause a processing delay.

| | | | |
|------------------|--|--|------|
| Sign Here | Under penalties of perjury, I declare that I have examined this submission, including any accompanying documents, and to the best of my knowledge and belief, all of the facts contained herein are true, correct, and complete. | | |
| | Taxpayer's signature | | Date |
| | ▶ | | |

| | | | | | |
|-------------------------------|----------------------------|----------------------|------|---|------|
| Paid Preparer Use Only | Print/Type preparer's name | Preparer's signature | Date | Check <input type="checkbox"/> if self-employed | PTIN |
| | Firm's name ▶ | Firm's EIN ▶ | | | |
| | Firm's address ▶ | Phone no. | | | |

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Appendix B – VCSP Temporary Eligibility Expansion Computation Worksheet

| | |
|--|------------------------|
| Taxpayer's Employer Identification Number (EIN) | Taxpayer's Name |
| | |

VCSP Temporary Eligibility Expansion Computation Worksheet
Attach this Worksheet to Form 8952. Do not send payment with Form 8952.

Taxpayers seeking to participate in the VCSP Temporary Eligibility Expansion must use this worksheet instead of completing Part IV of Form 8952. Attach this worksheet to Form 8952.

Part IV: Payment Calculation using Section 3509(b) rates

| | | | |
|---|------------|------------|------------|
| 18. Enter total compensation paid in the most recently completed calendar year to all workers to be reclassified (see Form 8952 instructions) | 18. | | |
| 19. Multiply line 18 by 5.03% (.0503) | | 19. | |
| 20. Enter any compensation included on line 18 that exceeded the social security wage base for any worker or workers for the most recently completed calendar year (see Form 8952 instructions) | 20. | | |
| 21. Subtract line 20 from line 18 | 21. | | |
| 22. Multiply line 21 by 7.88% (.0788) | | 22. | |
| 23. Add line 19 and line 22 | | 23. | |
| 24. Multiply line 23 by 25% (.25) | | | 24. |
| 25. Number of non-filed Forms 1099 for the previous three years for all workers to be reclassified | | 25. | |
| 26. Form 1099 Penalty Calculation: If line 25 includes: • 1 to 25 non-filed Forms 1099, multiply line 25 by \$50 • 26 to 49 non-filed Forms 1099, multiply line 25 by \$75 • 50 or more non-filed Forms 1099, multiply line 25 by \$100 | | 26. | |
| 27. Form 1099 Max Penalty: If Line 25 includes • 1 to 25 non-filed Forms 1099, enter \$500 • 26 to 49 non-filed Forms 1099, enter \$3,675 • 50 or greater non-filed Forms 1099, enter \$10,000 | | 27. | |
| 28. Enter lesser of line 26 or line 27 | | | 28. |
| 29. Add line 24 and line 28. This is your VCSP Temporary Eligibility Expansion payment | | | 29. |

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